



Chapter 3

Demand, Supply, and Market Equilibrium

Chapter Objectives

- Demand and its determinants
- Supply and its determinants
- Supply, demand, & market equilibrium
- Changes in supply and demand
- Government-set prices

A Market

- Interaction between buyers and sellers
- Buyers demand goods
- Sellers supply goods
- Assumptions
 - Standardized good
 - Competitive market

Demand

- Schedule or curve
- Amount consumers *willing and able* to purchase at a given price
- Other things equal
- Individual demand
- Market demand

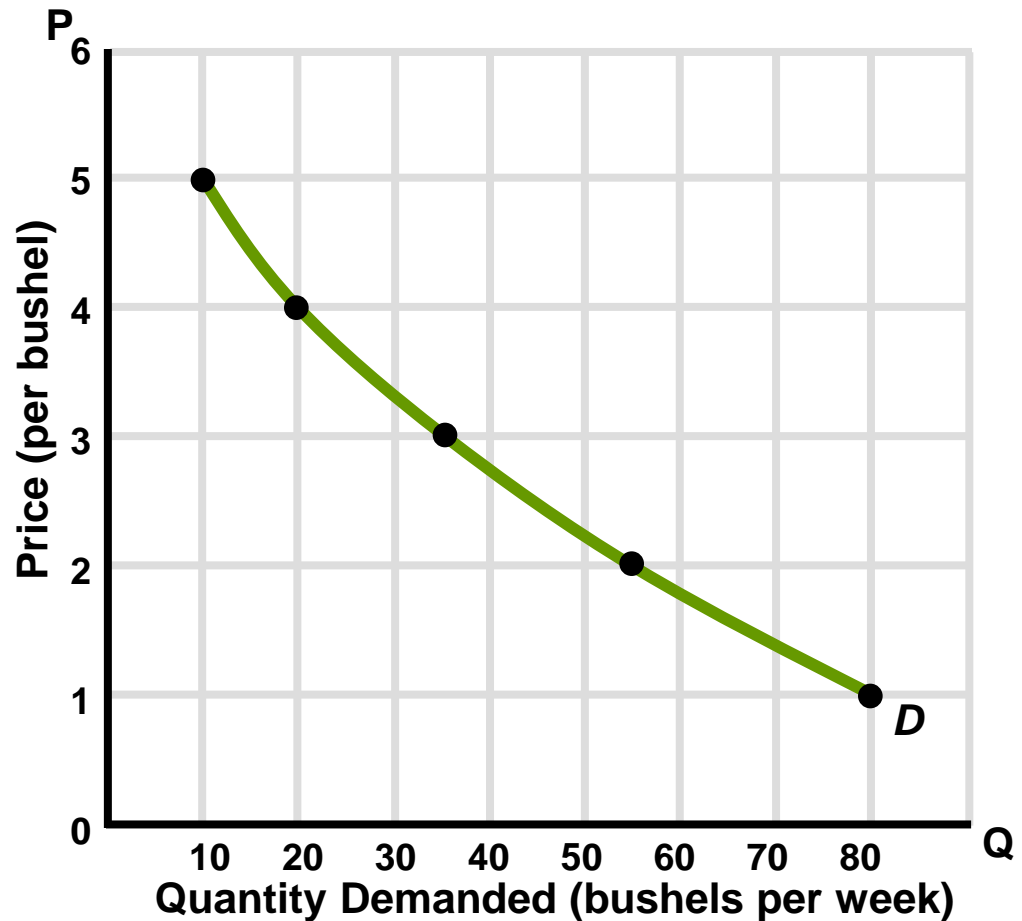
Law of Demand

- Other things equal, as price falls quantity demanded rises
- Explanations:
 - Diminishing marginal utility
 - Income effect
 - Substitution effect

Individual Demand

Individual Demand

P	Q_d
\$5	10
4	20
3	35
2	55
1	80



Determinants of Demand

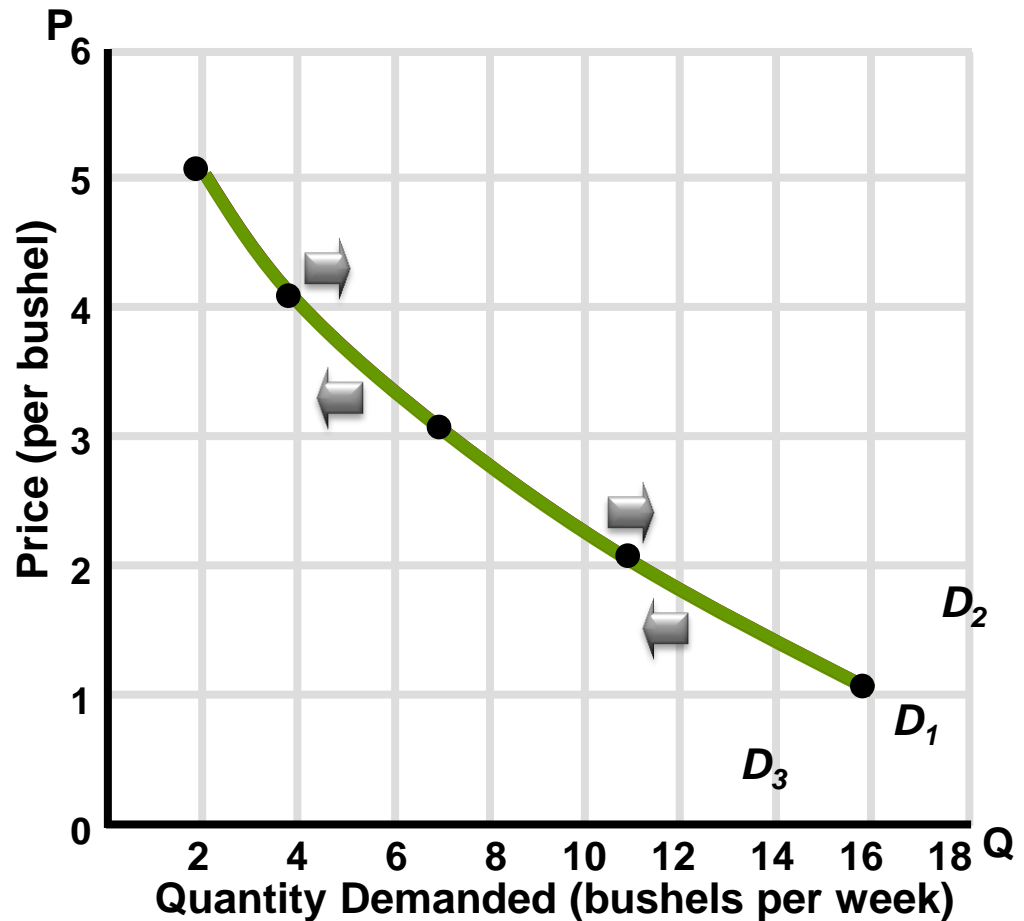
- Factors that shift the demand curve
- Cause more or less to be bought at any possible price
- Increase or decrease in demand
- Tastes
- Number of buyers

Determinants of Demand

- Income
 - Normal goods
 - Inferior goods
- Price of related goods
 - Substitute good
 - Complementary good
 - Unrelated goods
- Consumer expectations

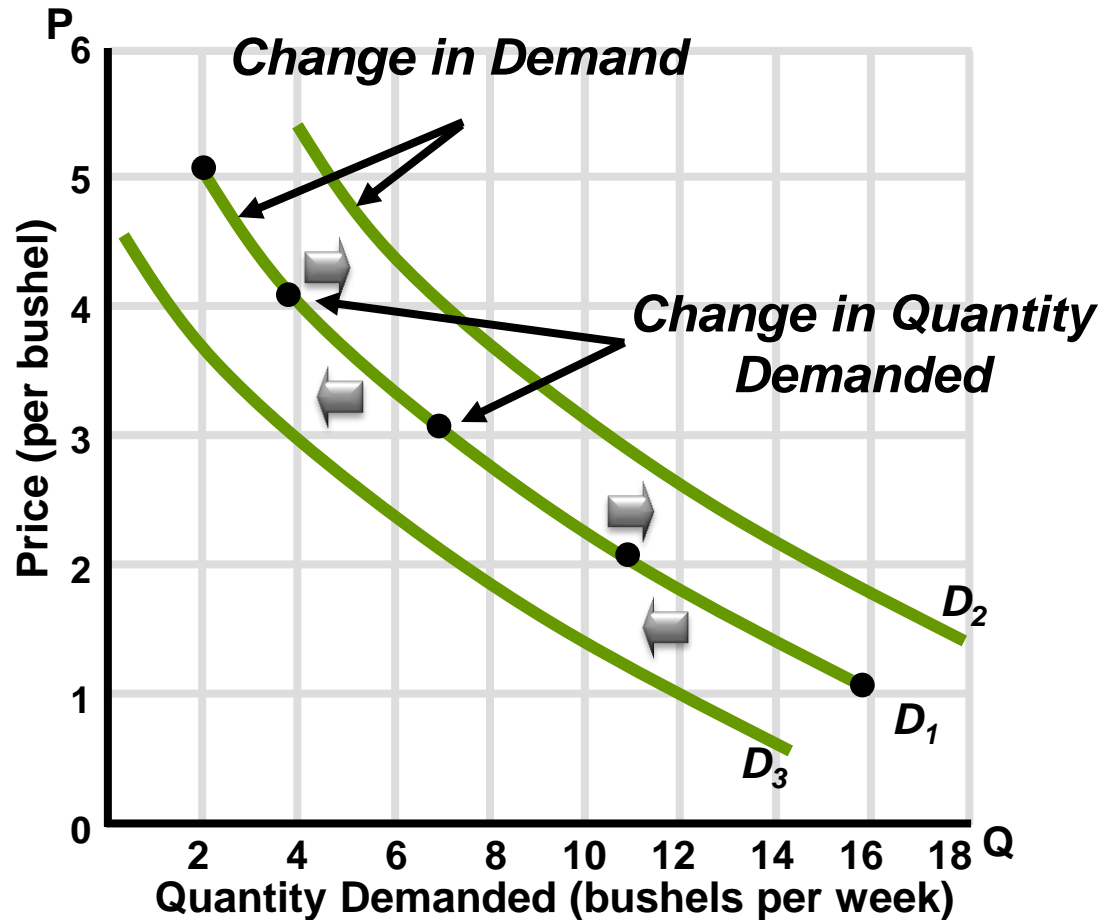
Individual Demand

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Supply

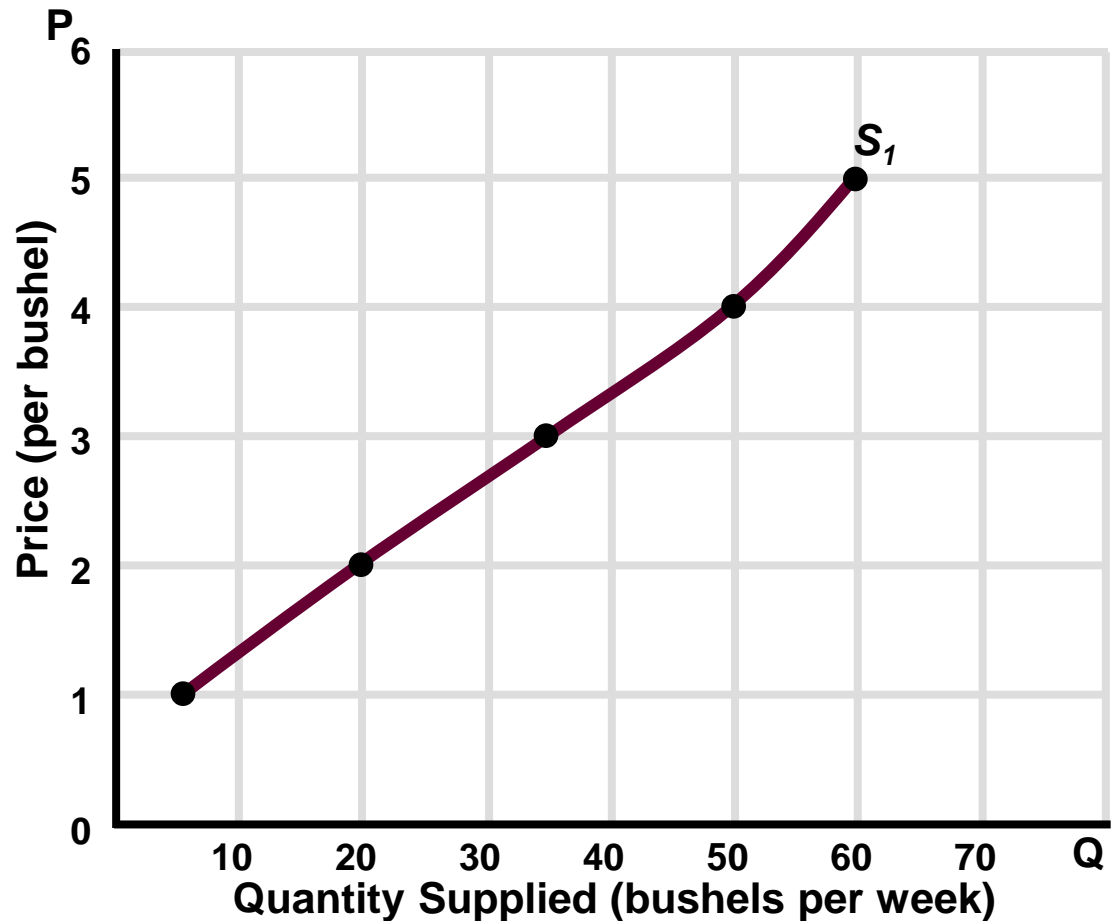
- Schedule or curve
- Amount producers *willing and able* to sell at a given price
- Individual supply
- Market supply

Law of Supply

- Other things equal, as price rises the quantity supplied rises
- Explanations:
 - Revenue implications
 - Marginal cost

Individual Supply

P	Q_s
\$5	60
4	50
3	35
2	20
1	5

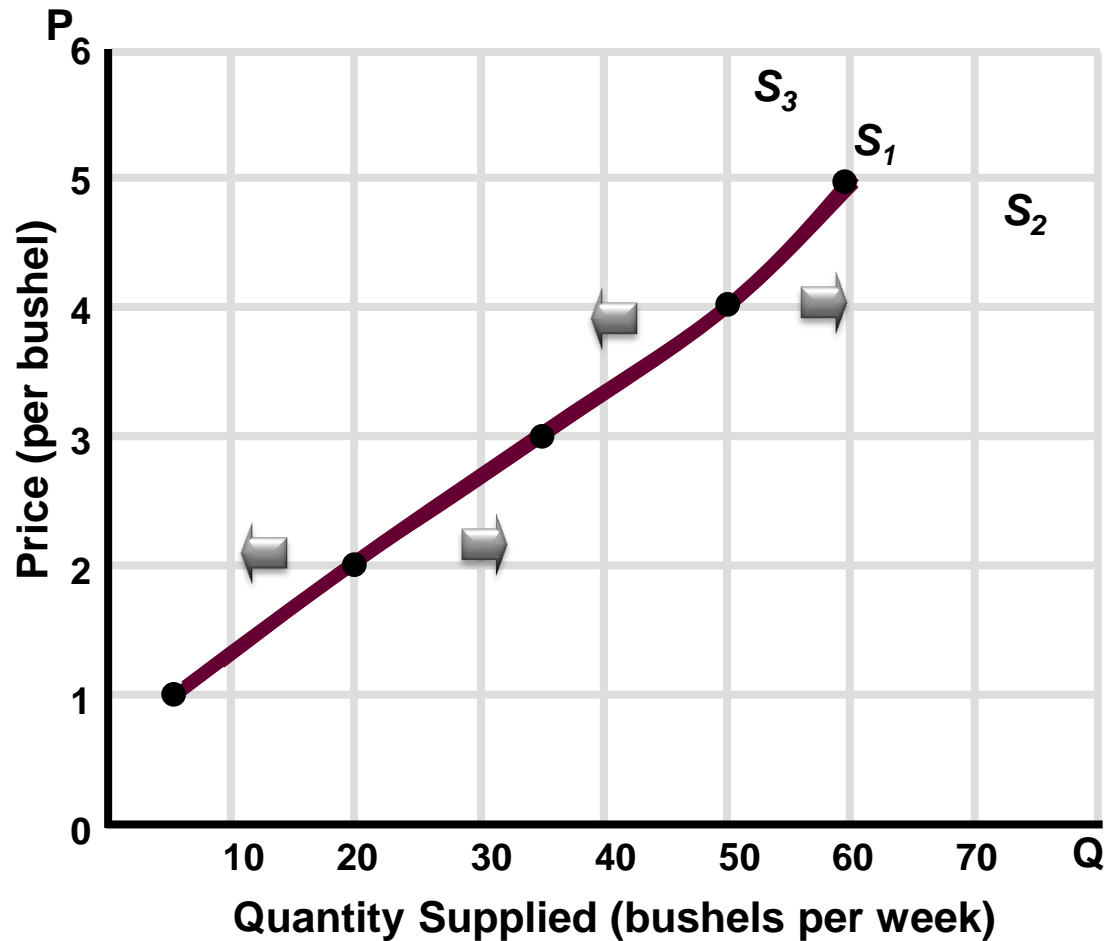


Determinants of Supply

- Resource prices
- Technology
- Taxes and subsidies
- Prices of other goods
- Producer expectations
- Number of sellers

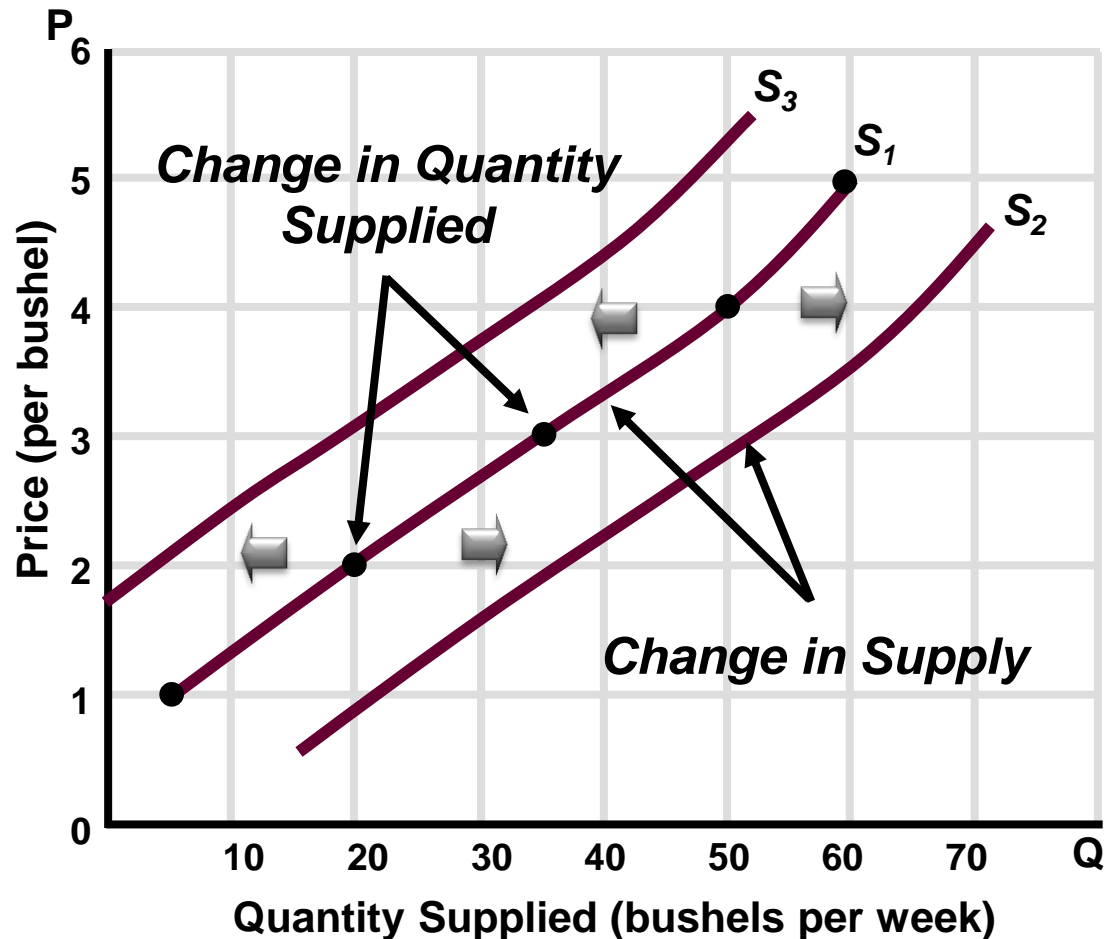
Individual Supply

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Individual Supply

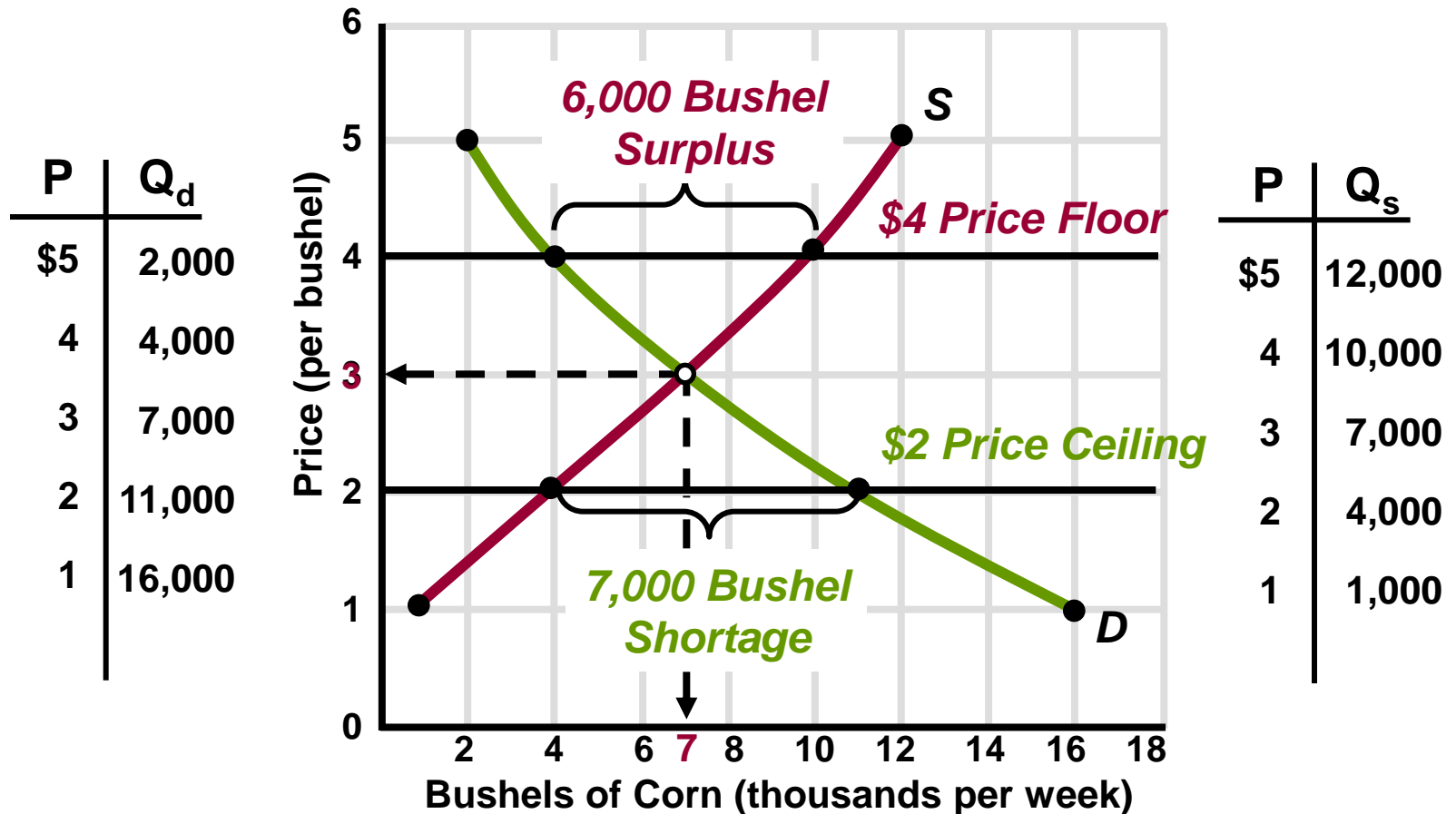
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Market Equilibrium

- Equilibrium price and quantity
- Surplus and shortage
- Rationing function of price
- Efficient allocation
 - Productive efficiency
 - Allocative efficiency

Market Equilibrium



Market Equilibrium

- Change in demand
 - Shift of the demand curve
- Change in supply
 - Shift of the supply curve
- Change in equilibrium price and quantity

Market Equilibrium

	<u>Price</u>	<u>Quantity</u>
• Supply increase; Demand decrease	↓	?
• Supply decrease; Demand increase	↑	?
• Supply increase; Demand increase	?	↑
• Supply decrease; Demand decrease	?	↓

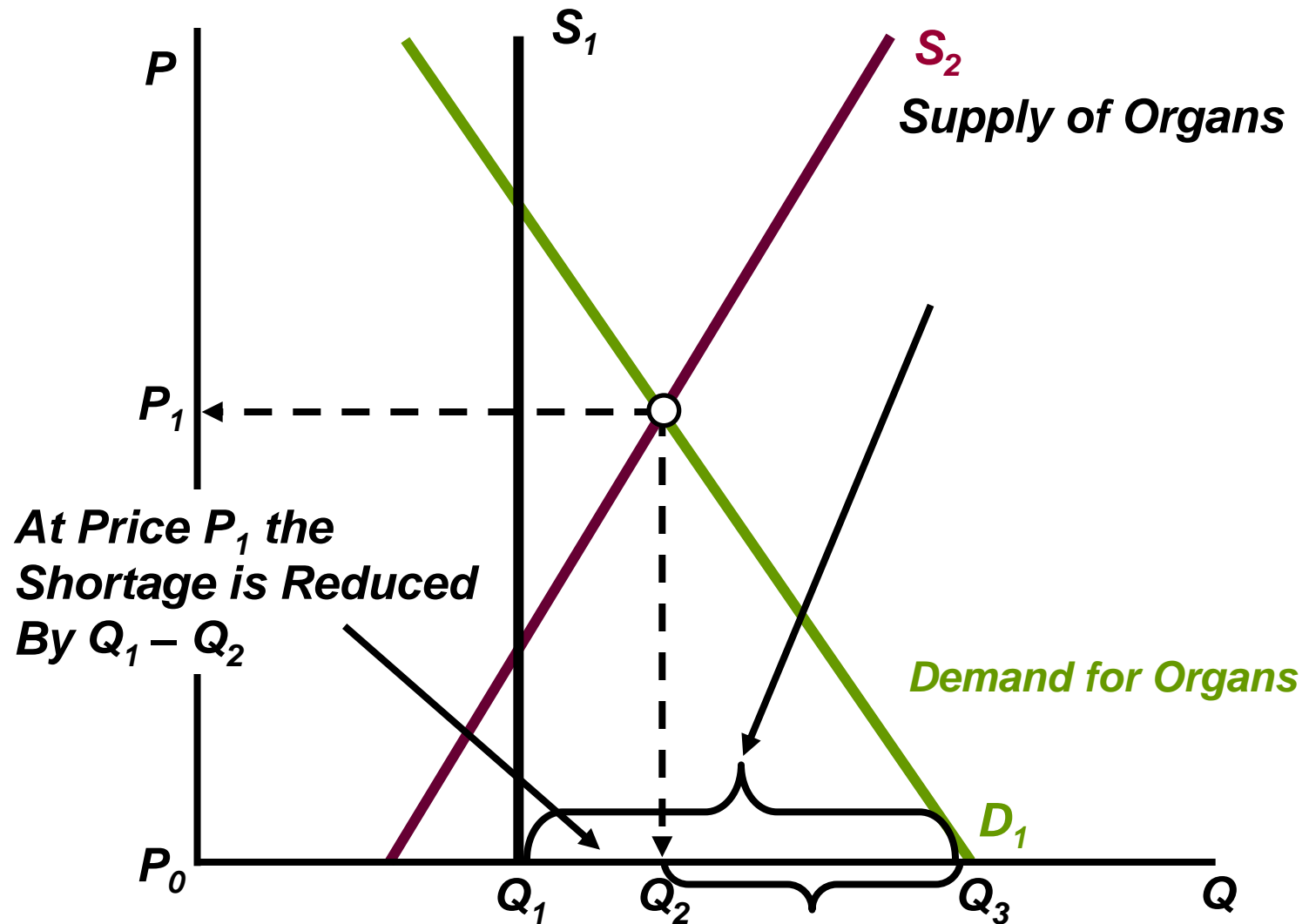
Government-Set Prices

- Price ceilings on gasoline
 - Rationing problem
 - Black markets
- Rent controls
- Price floors on wheat
 - Optimal allocation of resources

A Market for Human Organs

- Waiting list for transplants
- Demand for organs
- Supply of organs—two possibilities
- Market eliminates shortage
- Moral objections
- Legalize and regulate?

A Market for Human Organs



Key Terms

- demand
- demand schedule
- law of demand
- diminishing marginal utility
- income effect
- substitution effect
- demand curve
- determinants of demand
- normal goods
- inferior goods
- substitute good
- complementary good
- change in demand
- change in quantity demanded
- supply
- supply schedule
- law of supply
- supply curve
- determinants of supply
- change in supply
- change in quantity supplied
- equilibrium price
- equilibrium quantity
- surplus
- shortage
- price ceiling
- price floor

Next Chapter Preview...

The U.S. Economy: Public and Private Sectors